DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 01-0162
Financial Institutions Tax
For the Years 1992 through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Constitutionality of the Indiana Financial Institutions Tax.

Authority: U.S. Const. art. I, § 8; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1974); IC 6-5.5-1-12; IC 6-5.5-1-12, 13; IC 6-5.5-1-17(a); IC 6-5.5-1-18; IC 6-5.5-2-1(a); IC 6-5.5-2-2; IC 6-5.5-2-3; IC 6-5.5-3-1(6); IC 6-5.5-5-1(a).

Taxpayer argues that it does have an Indiana nexus and that the imposition of the Financial Institutions Tax (FIT) violates the Commerce Clause and is unconstitutional.

II. Computational Errors.

Authority: IC 6-8.1-5-1(a); IC 6-8.1-5-1(b).

Taxpayer maintains that the Department of Revenue (Department) audit report contains numerous computational errors; taxpayer asks that the Department's audit personnel return to taxpayer's out-of-state business location and explain the basis for the audit report's methodology and conclusions.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c)

Taxpayer states that because of the Department's mistaken conclusions as to the applicability of the FIT and because of the Department's numerous computation errors, the ten-percent negligence penalty should be abated in its entirety.

STATEMENT OF FACTS

Taxpayer is an out-of-state bank holding company. Taxpayer – along with its subsidiaries – provides a variety of consumer and commercial financial services. Beginning in 1999 and extending through 2001, the Department conducted an audit review of taxpayer's 1992 through 1996 business records and tax returns. The final audit report was completed in February 2001. The report found that taxpayer had failed to submit FIT returns and that it owed unpaid taxes for three of the years considered during the review process. As a result, in May 2001 the Department

issued notices of "Proposed Assessment" for 1992, 1993, and 1996 in which taxpayer was billed for additional tax. Taxpayer determined that the assessments were incorrect and submitted a protest to that effect during June 2001.

There is nothing in the record indicating that the Department acted on the protest letter until June 2003 when the original protest was submitted for administrative review. There is nothing in the record which indicates that taxpayer chose to pursue its initial protest after it submitted the 2001 protest letter.

Taxpayer was notified in June 2003 that its protest was being administratively reviewed and that it was entitled to participate in a hearing and to submit additional information justifying the basis for the protest. From June 2003 until May 2004, taxpayer took no further action and declined the opportunity to participate in an administrative hearing or to provide additional documentation to substantiate the protest. Consequently, this Letter of Findings is based upon the contents of the original June 2001 protest letter and on phone conversations which took place with taxpayer's representative.

DISCUSSION

I. Constitutionality of the Indiana Financial Institutions Tax.

Taxpayer maintains that it is not subject to Indiana's FIT because it does not have nexus with the state and that the Department's attempt to assess the tax offends the Commerce Clause (U.S. Const. art. I, § 8). Taxpayer asks the Department to "please withdraw this assessment."

Within Indiana, "There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC 6-5.5-2-1(a).

For purposes of the FIT, a "'[t]axpayer' means a corporation that is transacting the business of a financial institution in Indiana, including any of the following:

> (1) A holding company.
> (2) A regulated financial corporation.
> (3) A subsidiary of a holding company or regulated financial corporation.
> (4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution." IC 6-5.5-1-17(a).

The FIT is imposed on both "nonresident taxpayers" and "resident taxpayers" transacting the business of a financial institution within this state. IC 6-5.5-1-12, 13. The statute defines a "nonresident taxpayer" as "a taxpayer that (1) is transacting business within Indiana as provided in IC 6-5.5-3; and (2) has its commercial domicile outside Indiana." IC 6-5.5-1-12. A resident taxpayer, not filing a combined return, determines its FIT liability based on the resident taxpayer's adjusted gross income from whatever source derived. IC 6-5.5-2-2. In contrast, a nonresident taxpayer determines its FIT liability based on its apportioned income consisting of the taxpayer's adjusted gross income "multiplied by the quotient of (1) the taxpayer's total

receipts attributable to transacting business in Indiana . . . divided by (2) the taxpayer's total receipts from transacting business in all jurisdictions . . . ." IC 6-5.5-2-3.

The FIT definition of "transacting business" within this state includes the activities of a company which "regularly engages in transactions with customers in Indiana that involve intangible property, including loans . . . [that] result in receipts flowing to the taxpayer from within Indiana." IC 6-5.5-3-1(6).

Taxpayer challenges the three-year FIT assessment on the ground that taxpayer does not have a substantial nexus with Indiana. In Complete Auto Transit Inc. v. Brady, 430 U.S. 274 (1974), the Supreme Court stated that a tax will not be deemed to interfere with interstate commerce when it "is applied to an activity with a substantial nexus within the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state." Id. at 279.

The Department must disagree with taxpayer's contention that the assessment of the FIT is unconstitutional because, during 1992 through 1996, taxpayer owned subsidiaries which were doing business within Indiana and because those subsidiaries were earning money from business activities conducted within the state. Taxpayer does not challenge the determination that the subsidiaries were members of taxpayer's "unitary group" as defined under IC 6-5.5-1-18. Taxpayer's constitutional argument does not avoid the fact that it was required to file a combined return reporting the financial activities of the unitary group under IC 6-5.5-5-1(a). "[A] unitary group consisting of least two (2) taxpayers *shall file* a combined return covering all the operations of the unitary business and including all of the members of the unitary business." Id. (*Emphasis added*).

Taxpayer has provided nothing upon which to base its conclusion that the FIT assessment was not based upon a fair apportionment of the unitary group's business, that the assessment was unrelated to the services the subsidiaries received from this state, or that assessment impedes interstate commerce.

Taxpayer is a banking holding company conducting – by means of its subsidiaries – the business of a financial institution within Indiana. Therefore, it was required to timely file FIT returns reporting the adjusted gross income of its unitary group. To the extent that taxpayer challenges the constitutionality of the FIT as applied to non-resident companies having only an "economic nexus" with Indiana, the Department declines to address the question because the Department will not overturn a tax scheme crafted by the state legislature based upon taxpayer's facial constitutional challenge and because the Department does not agree with taxpayer's argument that it has only an abstract economic presence within this state.

FINDING

Taxpayer's protest is denied.

II. Computational Errors.

Taxpayer argues the FIT assessment is erroneous because the original audit report contains numerous and substantial mistakes. As taxpayer states, "There are too many corrections that need to be made to the audit's workpapers, that they can't be all listed in this protest." Among

other errors, taxpayer complains that the audit workpapers employ an "Indiana credit factor" but does not explain how the factor was calculated. Taxpayer maintains that the amount of gross receipts does not take into account foreign branch gross income and that there are errors in the calculation of foreign source income and foreign gross receipts. In addition, taxpayer complains that the audit relied upon information contained within its annual report "but does not take into account that there is foreign source income in these numbers."

Taxpayer failed to file FIT returns for the years considered by the audit review. IC 6-8.1-5-1(a) states that, "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis for the best information available to the department." At the time the Department conducted the audit review, taxpayer was unable to provide the requested information because – according to the taxpayer – the information simply did not exist. Taxpayer explained that because of changes in its structure, mergers with other banks, the discharge of certain key personnel, and because of certain storage problems – including a warehouse fire – it was not possible to provide the detailed financial information requested. Because the information was not available, the Department extrapolated information from 1996 in order to project income for 1992 through 1995. In addition, the department relied upon information contained with taxpayer's annual and 10-K reports.

Taxpayer now complains that the methodology employed by the audit was flawed. However, taxpayer has provided no specific basis for challenging the audit report's conclusions. Instead – seeing itself deeply aggrieved – expects that the Department will return to its corporate headquarters, reexamine the same incomplete records, and arrive at different results after having explained and justified each and every step of the audit process.

The original audit examination was conducted over a period extending from approximately 1999 through 2001. There is not a shred of substantive evidence which would justify revisiting this lengthy audit process based simply upon taxpayer's dissatisfaction with the results of the original audit when that report was based upon the information – albeit incomplete – which the taxpayer itself supplied to the audit. In addition, it should be noted that taxpayer declined the opportunity to provide additional information during the 11-month administrative review process and declined the opportunity to take part in an administrative hearing during which it would have the opportunity to more fully explain the basis for its complaint.

Faced with a taxpayer which failed to file FIT returns for five years, the audit relied upon the abbreviated information which taxpayer provided. The audit was entirely justified in making "a proposed assessment of the amount of the unpaid tax on the basis for the best information available to the Department." IC 6-8.1-5-1(a). After the Department's audit personnel reviewed the available records, after the personnel consulted with taxpayer's representatives, and after those personnel prepared the final audit report, it was the taxpayer's responsibility to provide a basis for refuting that report. IC 6-8.1-5-1(b) states that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Taxpayer has not met its burden of demonstrating that the proposed assessments are incorrect.

FINDING

Taxpayer's protest is denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty. In its June 2001 protest letter, taxpayer maintains simply that "no penalties should be assessed."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Taxpayer did not file FIT tax returns, was audited during by the Department, and was assessed for three years of unpaid taxes. Taxpayer is a substantial, sophisticated business receiving large amounts of money from sources within Indiana. Taxpayer's larger constitutional question aside, the decision to overlook this state's FIT is not the evidence of the "ordinary business care and prudence" expected of an "ordinary reasonable taxpayer" that would warrant abatement of the ten-percent negligence penalty.

FINDING

Taxpayer's protest is denied.

DK/JM/MR – 041706